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DEPOSITORY

FARM CREDIT IN THE SOUTH

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One of the commonly cited evidences of the advanced state of present day economy is the fact that the great part of business transactions of all kinds is conducted by means of credit. In place of a direct use of cash or trade we now increasingly employ promises to pay to accomplish the same ends. The use of credit has greatly extended the period within which transactions may be consummated. Farms are bought with the term of payments equal to the span of a generation, and amortization loans are made with a term of years equal to a third of a century.

Basically the transaction has remained of the same nature as when a plow or a farm was bought for cash. The credit transaction, however, depends upon the successful completion of a process yet to be performed and therefore introduces various elements of chance which may enter to interfere with carrying out the agreement as planned.

The recognized advantages of the modern credit system have sometimes obscured the dangers and limitations to which it is subject. Perhaps because the use of credit appeared first in urban society and only later in agriculture, organization and development of farm credit has been slower than that of industry. Probably the long period of an agricultural frontier, continuing through most of the country's history, retarded both the need and the appearance of a mature credit structure for agriculture. In consequence, the acquisition of credit experience by farmers has successively revealed the need for more adequate and more refined facilities, and has likewise disclosed the need for observing certain cautions and safeguards.

Many of the danger points in farm credit usage appear both in its short and long term aspects. Short term difficulties are probably more apparent, however, because of the frequent observation of the day to day credit dealings with their many obvious abuses of good business practice. It may be observed, for example, that some people arrange for and use more credit than they need. Others under the inducement of credit or easy payments are persuaded to purchase articles of questionable value, or to incur obligations in excess of their income. Very often the cost of such credit is so connected with the price quotations of the goods that the purchaser is unaware of the actual amount paid for the credit service. This and other faulty credit usage is by no means confined to farmers but it is common enough in the country to constitute a part of the farm credit problem. Neither are farm credit difficulties found only in the South though for the purposes of this discussion attention will be directed to that area.

One of the most pressing needs in farm credit is more discrimination by the borrower. This is particularly striking in the case of short term credit in the South where the investigator finds frequent illustration of the need of a more careful and critical attitude on the part of the individual farmer when making his credit arrangements. For example, there are probably relatively few farmers who do not know that time credit with merchants is generally several times as expensive as cash credit. Yet one continually finds farmers with good bank standing who are accustomed to obtaining substantial parts of their credit from merchants and dealers.

Not unusual is the Southern farmer who, having a fair amount of property and who ordinarily uses credit does not make any use of the bank's facilities whatever, keeps his cash at home and has never had any relations with the bank nor tried to establish such relations. Meanwhile, he often continues to use merchant credit of other forms more expensive than bank credit would be. It is obvious that so far as this class of farmers is concerned improvements in credit facilities will render little or no aid. Meanwhile, their policy of non-patronage may prevent the appearance of a bank of the character desired.

Another widespread need of better credit usage is illustrated by the farmer who borrows money or buys goods on time but does not undertake to learn what is the cost of the credit so obtained. This occurs most commonly where flat rates are used. This practice of flat rates is especially common to the South. In many other areas it is unknown. But in the South it is widely used by both merchants and banks. Under this method of charge, if the rate quoted is 6 per cent or 8 per cent the farmer may not ask whether it is 6 or 8 per cent per annum or 6 or 8 per cent of the principal, and inquiry has shown that he very often does not know which rate is to be paid. When a flat rate is charged of course the per annum cost is two to four times the same figure on a per annum basis if the term runs only six months or three months. The general institution of flat charges, especially when used in connection with the purchase of goods, obscures credit costs. The charge made for each of the considerations involved in this type of transaction cannot be readily identified, so that intelligent comparison with other credit costs becomes impossible. There is a great need to educate farmers to an appreciation of these credit differences.

Severe Loss From Uncollected Credit Accounts

The high rates of credit cost often found in the South are commonly looked upon as heavy expense to the borrower. Because of the unpaid balances on many of the accounts however they should also be viewed as a great loss to the community as a whole. Various studies have shown that a considerable part, often ranging from one-fourth to one-half, of the cost of credit advances by merchants to farmers, or by farm owners to their tenants represents allowance for unpaid credit. Much of this loss is due to unwise advances for unprofitable enterprise which results in the annual sinking of that much capital. No area should allow itself the luxury of such waste, but the generally high credit cost in the South indicates that probably more of this expensive practice is found there than elsewhere.

Losses from uncollected advances may spring from carelessness, bad planning, neglect by the borrower, or from poor management by the lender whereby poor risks or unsound ventures are financed. This present heavy loss could be materially reduced by a greater use of cash and less of time credit, and accumulation of at least small reserves by the farmer in good years. This would lead to a greater sense of individual responsibility. Important in any program of credit improvement must be the education of the farmer in financial management. This work must be carried on not only by research and instructional staffs, but also by extension and other agricultural workers with the aid of publications at their command.

Long Term Credit Problems

Events of the past decade have compelled greater attention to the long term aspects of the farm credit problem than at any time for a generation. Both a maturing foreign competition in agriculture, and serious price changes enforce this view. A generally falling price level has made more difficult the payment of obligations than would have been true with the same amount of farm products earlier in the period. Prices of crops and stock have fallen approximately one-half since 1920 while land values have declined from 170 to 115 on a 1912-14 base of 100. On long term indebtedness or on credit carried over from one year to the next this shrinkage of dollar values has materially increased debt burdens while the slower turn-over of the farm assets has made the problem particularly difficult for the farmer to solve.

This is the third time in a century that prices having risen to extreme heights have subsequently declined to levels approaching or actually lower than when the sharp rise began. These price peaks have sometimes been far enough apart that whole generations have escaped their more precipitate changes. For the generations which have experienced their rise and fall, however, the severity of their action through expansion of dollar obligations followed by contraction of debt paying power has brought about the economic ruin of large numbers. The events since 1920 have provided another lesson in credit management during such movements, the need of caution in incurring debt. Granted that price changes are always elusive and difficult of prediction, and that in 1920 there were many who declared that the high price level would be permanent, the three experiences of the past century, however, would indicate that should future events bring about another pronounced rise in prices the burden of proof will be upon those who say that the level of prices will not fall.

Farm mortgage credit naturally involves more of the long term hazard than do other kinds of borrowing. This form of credit was slower to come into general use in the South than in other parts of the country. Even yet a smaller percentage of Southern farms report this type of credit than do farms in other major agricultural regions. This may be due in part to the smaller number of voluntary transfers of land which occur in the older South. Approximately 25 per cent more of the farms in that section pass by inheritance than in other parts of the country. Fewer transfers result in fewer occasions requiring large amounts of credit such as are represented by the typical mortgage. However, since 1910 the South has registered the steadiest growth in the use of mortgages of any area, 150 per cent from 1910 to 1920, 20 per cent from 1920 to 1925, and 8 per cent from 1925 to 1928. During the past year or two, however, loans of important agencies have declined in the South in common with most sections of the country.

Since the adoption of the Federal Farm Loan Act in 1917 the South has made relatively greater use of loans under its provisions than has any other section. In view of this fact it is the more surprising to find some communities in the South where interest rates on first mortgages range from $5\frac{1}{2}$ per cent to 10 or 12 per cent. Such cases are further evidence that one of the greatest needs for better farm credit practice is a more alert appreciation of credit differences in rates and terms on the part of farmers themselves.

In view of the need of reorganization of many southern farms, such as discussed in other sessions of this conference, greater use of mortgage credit would be warranted for the purpose of enlarging farms now too small for effective economic units, too small to permit profitable use of machinery, and too small to provide an adequate living standard. The marked decline in land prices has made such adjustments in farm units more feasible now than has been true for many years in the past. Nevertheless the need for caution continues. The borrowing limit should be the amount that can be carried rather than the amount that can be obtained.

The necessity of taking a long view of farm mortgage credit appears when it is realized that the average Southern farm once mortgaged remains under debt for a period of approximately 25 years. This fact cannot be impressed too strongly on the farmer. The term of the mortgage usually extends for only a few years. Aside from the land bank loans mortgage terms actually average only about 5 years. Nevertheless the debt goes on. Usually it is renewed several times, and if money conditions happen to be unfavorable at a due date, there is always difficulty. Such troubles occurred notably in 1920-21 and in 1929 when land banks could not sell bonds at rates which would permit practicable loaning, and when a considerable part of the loan funds of other agencies were being used for more profitable purposes.

Farm Management Considerations in Credit

Many of the phases of the farm credit problem are basically problems in farm management. Thus the small size of many loans to farmers appears to be a credit problem. Small loans typically involve as much handling charges as larger loans. The real difficulty in most such cases, however, lies deeper than the credit operation itself. Actually, very often this is a problem in farm organization. The scale of farm operations often is so small that the farmer's credit transactions, in common with other farm business, are conducted at a disadvantage. The difficulty of the undersize farm is likely to register in mortgage credit also. The small mortgage loan is likely to be unattractive to the most economical sources of credit so that the final arrangement is likely to be made a high rate. This phase of the credit problem, therefore, can find its solution only in the acquisition of a larger and more economic farm unit.

Perhaps the most vital requirement of good credit management on the farm, especially whenever the ratio of debt to value is high, is concerned with the relation of credit cost and the rate of farm return. It is elemental that an excess of cost over return first tends to reduce the equity and eventually to cause loss of the property. Yet this fact is very widely ignored among farmers, and recent years have produced many tragic results in loss of farms to their owners. The Southeastern States have had a higher percentage of mortgaged farms foreclosed than has any other area of similar size.

The existence of an unprofitable ratio of expense to income usually can be determined by a comparison of farm expense and return over a short period of years. An unfavorable trend should not be allowed to run a complete course ending in the loss of the farm. A greater use of farm accounting sufficiently detailed to tell the farmer what rate of return he is getting on his investment is a necessary step for the attainment of improved farm credit practice on a large part of the farms in the South.

These cases illustrate the necessity of testing proposed credit operations by the criteria of best farm practice in both its immediate course and long time trends. We who are interested in farm credit should keep closely in view the results of the work of our colleagues in farm management and of the technical workers who are sifting out the poor from the best farm practices. We need to remind ourselves that nearly every credit transaction is in reality the projection into the future of some plan of farm operations.

The credit risk over a large part of the South is materially increased by the continued reliance upon a single crop. Supporters of this one-crop policy have based their position upon the belief that in the long run concentration upon the crop which could be grown best was the most profitable. The past season, however, has again demonstrated the necessity of at least one important qualification of such a program, namely, that the one crop production plan must be sufficiently profitable to provide an adequate reserve of money and supplies against occasional years when because of lack of rain fall or other cause the crop income fails. This means that production in many such areas must be reorganized on a more extensive scale so that by means of larger production of the same crop or by addition of other crops or livestock production, both gross and net farm income will be increased. There is continued operation of great numbers of farm owners and tenants in the South at the very margin of economic survival even in normal years. In bad years because of no reserves the farm operations are crippled and the farmer himself is reduced to want and distress. This cannot be reconciled with good farm management and therefore cannot form the basis of an adequate system of farm credit as long as this condition continues.

Farm Credit and the Country Banks

The principal link which connects the farmer with the outer world of credit and finance is the country bank. This remains true despite the fact that during the past decade great numbers of these institutions have proved to have been not strongly enough established to withstand the stress in long credit experience and have failed. These difficulties illustrate one of the most serious long time dangers in the use of credit. The great majority of the banks operating in the South in 1920 had been formed during the long period of rising prices from 1896 to 1920. These banks came into existence and had their entire experience in a period in which the value of the assets on which they loaned money was generally greater each year than the year before. Because of generally advancing prices from 1896 to 1920 the value of the farmer's products proved to be increasingly ample means of payment. Moreover, the land itself, in which farm the farmer had three quarters of his capital, annually increased in value, could readily be sold, and came to be viewed as acceptable security. It was the most common form of investment for surplus funds. Banks had little difficulty with collections. Depositors acquired growing confidence. Loans were readily obtainable.

Events since 1920 have shown that this set of conditions provided an unsafe training for a generation of credit managers in meeting the banking problems which appeared during the past decade, a period in which values were declining and conditions were generally reversed. The fact that approximately 80 per cent of the banks have survived the extraordinary strain of recent years is a tribute to the capacity and persistence of great numbers of bankers.

The fact remains, however, that the epidemic of bank failures has shown that the financial institutions of the country districts were clearly unprepared to meet the stress to which their position subjected them. As a group, about one in five has failed and in some districts nearly all the banks have failed. Whenever a failure has occurred it has spread financial demoralization in the community. The accustomed source of credit has been destroyed. The long cultivated understanding between borrower and the bank has been snuffed out. The farmer's deposits have been tied up and usually a good part of them lost, and often no other readily available place for deposit or loan was to be found. The fact that 1930 brought a record number of failures indicates that the problem is yet to be solved.

There cannot be a satisfactory system of farm credit nor a satisfactory system of farm economy in the South until there are facilities available to the farmer which provide adequate credit for all legitimate needs and a safe place for the deposit of funds. These facilities must continue to be available regardless of a crop failure in the previous year, or a run on the bank by frightened depositors, and despite price changes. In other words, the new credit system must be of such type and management as to rise above the local limitations and guard against economic dangers which have threatened the safety and capacity of most institutions serving the farmer in the past. To accomplish this purpose it may be granted that there will also have to be set up new criteria of safety for loans.

Because of the limitations of local institutions and interruptions in service, the farmers of many communities have found themselves effectually cut off from contact with the money centers of the country for considerable periods. In the failure of many banks in recent years farmers have been the chief sufferers. The fact that the bank's failure may have been partly due to an overextension of farm credit, has not softened the blow to the agricultural community when failure came. It is highly essential that the farmer should have ready contact with central reservoirs of credit at all times. The kind of institution which is to replace the local failed bank is therefore of prime interest to the farmer customer.

Farmers Should Demand Better Banks in Future

Gradually these failed banks will be replaced. The farmer should take some responsibility for seeing that the new banking facilities offered him do not contain the defects which brought about or permitted the downfall of the old institutions. The farmer has much at stake in this matter. He may not provide the principal capital for the bank, though many farmers are substantial stockholders in banks. Very often it will be the farmer's deposits, however, which make it possible for the bank to operate, and the interest he pays on loans which permits the bank to make a profit. These interests of depositor and borrower make the public responsibility of private banks very great. If the bank that failed is replaced by another no stronger and no better managed its customers will patronize it with the same hazards as they did the old one. If the size of the community or the nature of the business organization does not permit another and adequate bank to be formed the defective bank may continue to monopolize the field, with no good alternative available to the farmer. Unlike the metropolitan centers there often is no strong bank within convenient reach in the rural districts. The banks of the future should therefore be so organized as to perform the services which their customers may reasonably demand of them. It is unfortunate indeed when the customer's accommodation must be limited by defective facilities. The bank should be made to fit the farm business, not the farm business to fit the bank.

Prominent among the requirements for better banks must be that not too large a proportion of assets should be placed in one community. The Southern farmer often has been told that he should diversify his production and his assets. We have seen that the only condition under which he may safely disregard that policy is by the accumulation of reserves. There is even stronger reason that a bank serving the farmers should diversify its resources. For not only does it have the responsibility of continuous service for a community of people who may become subject to a common calamity but it has the responsibility for keeping intact the reserves which the farmer has provided against such emergencies. The most opportune time for the farmer to interest himself in this matter is the present while the banking situation is disorganized, while the lessons of recent failures are clearly in mind, and while there is time to apply constructive measures.

Agricultural Credit Corporations

The Federal intermediate credit banks were designed to supplement the commercial banks when necessary by rediscounting for designated classes of agencies. We appear to be still in the stage of experimentation with regard to determining the place in a system of production credit which is to be occupied by such agencies discounting with the Federal intermediate credit banks. In practice these discounting operations have encountered a number of obstacles. Various reasons have been given in explanation of the limited operations. Among these, are narrowness of the operating margin permitted, in view of the risk of the loans, especially in one-crop areas. This in turn, it is claimed, has made private capital reluctant to enter the field, while farmers often are unable to provide the capital. In other cases farmers appear to have been slow in assuming the initiative in undertaking organization of credit corporations. In some cases, the recognition of the emergency character of the situation which has given rise to their formation doubtless has retarded action toward organization.

During 1930 the movement toward cooperative enterprise and the utilization of Federal financing facilities received an unusual stimulus. Nevertheless, the suspension of over 1,300 banks during 1930 and the substantial reduction of the resources of many others, mostly in the agricultural areas, has been followed by the formation of only sixty agricultural credit corporations, and 9 livestock loan associations. This would seem to indicate that we have not yet worked out any ready transition method whereby the failure of established credit agencies is followed by the assumption of their responsibilities by agencies discounting with the intermediate credit banks.

The credit corporation formed in conjunction with a cooperative marketing association offers a special case in which a number of advantages may favor successful operation. Notable among these is the opportunity of having field men observe the loan during its term and of having first access to the product at the time of marketing. Furthermore, the volume of operations possible through such an organization may permit a handling cost per unit lower than would be possible otherwise.

On the other hand some disadvantages may appear. If the loans are scattered, special field supervisors may entail a unit cost as great as for other credit corporations. If credit is used as an inducement for obtaining members, gains in this respect may be offset by losses occasioned by poorer risks.

Experience to date has been that whenever the objectives of larger membership or greater volume of product. have employed the inducement of credit service to an extent not warranted by the individual credit risk the resulting consequences have had doubtful value.

Thus in this case also a clear distinction is needed as to the limitations and legitimate functions of credit. As long as advances are made to such individuals and in such amounts as offer assurance of repayment they represent anticipations of future business consummations of a self liquidating nature. Whenever credit extension exceeds these conditions they become potential sources of difficulty and loss for both borrower and lender, and it matters not what the lending agency may be, whether individual, bank, or cooperative, the unwise nature of the transaction will eventually assert itself as well as the fact that on a long term basis such credit operations cannot be carried on.

CONCLUSIONS

In conclusion, we need to remind ourselves occasionally that there is no magic in credit. What is borrowed must be paid back with interest. The extension of the term of credit does not change these facts, though extension may even heighten the difficulty of carrying out the credit contract. The experiences of the past decade of declining prices has provided one of the most forceful illustrations of this fact in our history by bringing about credit distress fatal to many individual farm enterprises and to farm credit institutions.

Basically, the enterprise to be financed embodies the real problem in farm credit. The accurate calculation of the profitableness and feasibility of the undertaking is the first responsibility of both borrower and lender. Accordingly, a thoroughgoing reorganization of the farm production unit often is of greater importance than additional credit on the existing basis.

Inseparable from all credit operations is the individual who is to use the borrowed capital and be responsible for the quality of its management. Great numbers of farmers do not figure closely enough on

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the cost of their credit and the alternatives of using less credit. A computation of this cost would show that for many farmers substantial savings are possible from choosing better sources of borrowing and from a practicable degree of self-sufficiency. In some studies the economies from these means have been found to approach the average amount of the farmer's annual increase in net worth.

In order that the farmer may have the necessary information to enable him to manage his finances intelligently there is need of further research in the credit both of representative local areas and on a wider scale. It is not enough that such inquiries should find the source, amounts, cost, term and other primary facts related to the credit used, though these points must be determined with precision and clarity of meaning. The investigator must also find out why a given kind of credit is high or low in cost, why and under what conditions the supply of credit may be expected to be scarce or abundant, why farmers continue to use less desirable forms of credit and to follow other uneconomical credit practices, and just what changes are necessary to bring about improvement of the existing conditions.

One of the most vital problems to Southern farmers during the next few years will be the establishment or reorganization of banks which will give continuous service to agriculture and be sound. The farmer as a depositor, borrower and one who hazards an important part of his business operations on the stability of the bank, should become articulate in demanding adequate financial institutions.

For the accomplishment of these objectives all people interested in agriculture should have a part. This is the most opportune time in a generation to make improvements in the credit practices of farmers and farm credit facilities in the South. Efforts to improve these features should form an integral part of reorganized production management program for the Southern farmers.

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